

Unlimited PTO in California – Is This Actually a Good Idea to Retain Employees?

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The COVID-19 pandemic sparked an ongoing upheaval in the California (and greater U.S.) labor market. Extensive job losses early in the pandemic have led to a tight labor market, which arose in part due to the phenomenon now known as the Great Resignation.

With employees resigning from positions at a record rate, employers are left scrambling to retain and recruit top talent by offering competitive pay and benefits. One benefit that has re-surfaced to the top of hiring managers' minds is unlimited paid time off ("PTO").

In theory, unlimited PTO is viewed as a powerful recruiting tool that combats burnout and encourages flexibility in work hours. In practice, however, implementing an unlimited PTO policy presents a number of issues that should be evaluated before implementing unlimited PTO as a retention tool. California employers should consider the following:

- **Do we have to provide PTO to employees?**

No. PTO is not a mandated leave in California. However, PTO policies can encompass leaves mandated by law (including California Paid Family Leave, California Paid Sick Leave, etc.) as well as vacation time. California law does not require employers to provide employees with paid vacation. However, if an employer chooses to provide paid vacation under a PTO policy, Section 227.3 of the California Labor Code requires the employer to pay any vested vacation time an employee has not used at the time employment ends, unless otherwise provided in a collective bargaining agreement. This payout is required because accrued vacation time is considered earned wages. The benefit of keeping mandated leave separate from PTO is that it does not have to be paid

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out on termination.

- **Are there risks in providing unlimited PTO?**

Yes. There are two main risks involved in providing unlimited PTO.

First, unlimited PTO policies only work if they are truly unlimited. A PTO policy is not “unlimited” if an employer provides an implicit or explicit cap, limitation, or “guidance” on the amount of PTO, such as stating, “We have an unlimited PTO policy, but an employee is expected to only take three weeks” or “Employer will approve a vacation request unless the employee takes an excessive amount.” A California appellate court decision illustrates this point: in *McPherson v. EF Intercultural Foundation, Inc.*, the employer had an unlimited vacation policy in place, but did not communicate that the vacation policy was unlimited and expected employees to take vacations of between two to six weeks each year. The court found that the policy was not truly unlimited with these limitations in place.

Because there is not a cap in place for unlimited PTO, bigger financial problems arise when the employee’s employment is terminated and a policy is found not to be a bona fide unlimited policy. Many employers choose to provide unlimited PTO because they do not want to pay out any accrued balances at termination. However, because unlimited PTO has no cap, the liability could be far greater than under their current vested vacation system.

Second, implementing unlimited PTO policies requires evaluating any effect on the duty to accommodate disabilities and leaves mandated by law. These common questions arise: “If an employee can take unlimited vacations, how can the employer limit time off for a disability? Pregnancy? Illness?” Sometimes employers answer these questions by implementing unlimited vacation, and leaving in place state-mandated requirements in providing sick days, disability accommodations, pregnancy and leave. However, by making a distinction between vacation and leaves mandated by law, employee morale could be impacted and the distinction could give rise to discrimination complaints if the policy is not drafted and administered properly—and consistently.

- **Are there alternative approaches to a “truly” unlimited PTO policy?**

Yes. In realizing the numerous risks involved in implementing an unlimited PTO policy, some employers adopt the following approaches as a way to set an objective standard.

First, employers may provide time off by implementing a “shut down/unplugged dates” policy. These employers note when there is a lull in business (for example, in the summer time, during the week of Thanksgiving, and in the last two weeks of December into January), and “shut down” during those times. During the shutdown, employers use a skeleton crew for coverage, and the employees who are off during those time periods are truly off and unplugged – no email, no phone calls, no meetings. By implementing a “shut down/unplugged dates” policy, as opposed to unlimited PTO, there could be significant savings in operational costs because normal operating costs are reduced and

the time does not have to be paid at termination.

Second, employers may provide an “unlimited” PTO policy that rests on productivity. In examining law or accounting firms, unlimited PTO policies are easier to implement in these settings because, generally, if the employee reaches the required number of hours of work, then the employee is entitled to take an unlimited amount of PTO.

Third, employers may provide an “unlimited” PTO policy that centers on a deliverable. In examining deliverables-based positions (such as positions focusing on launching a product or a movie, or those with specific sales targets, etc.), unlimited PTO policies can be implemented because, generally, the employee can take an unlimited amount of PTO outside of the designated production/launch time for the deliverable or so long as they are meeting the sales/ commissions expectations.

- **We understand the risks and alternatives, but we still want to provide a “truly” unlimited PTO policy to our employees. How should we draft our unlimited PTO policy?**

First, the employer should consider whether the unlimited PTO policy only encompasses vacation, or covers both vacation and leaves mandated by law.

Second, the employer should consider guidance from the *McPherson* case. In its opinion, the *McPherson* court provided helpful guidance for “truly unlimited time off policies.” The court explained that an unlimited PTO policy may not trigger Section 227.3 where, for example, in writing it:

- clearly provides that employees' ability to take paid time off is not a form of additional wages for services performed, but perhaps part of the employer's promise to provide a flexible work schedule—including employees' ability to decide when and how much time to take off;
- spells out the rights and obligations of both employee and employer and the consequences of failing to schedule time off;
- in practice allows sufficient opportunity for employees to take time off, or work fewer hours in lieu of taking time off; and
- is administered fairly so that it neither becomes a *de facto* “use it or lose it policy” nor results in inequities, such as where one employee works many hours, taking minimal time off, and another works fewer hours and takes more time off.

The court explained that an unlimited PTO policy “depending on the facts of the case[,] very well may not constitute deferred compensation for past services requiring payment on termination under section 227.3.”

- **How do we transition from an accrued PTO to unlimited PTO?**

Transitioning from accrued PTO to unlimited PTO involves careful consideration.

Set a deadline for California employees to use up accrued vacation time before the company transitions to unlimited PTO. However, because accrued vacation time is considered earned wages, California employees cannot be forced to “use it or lose it.”

The Company will have to monitor to ensure employees take the vacation or leave the accrual on the books until it is paid out, at the latest, upon termination of employment.

To help with the transition, employers also should consider the following:

1. Ensure all accrued vacation time is accurately tracked. Announce the change nine months in advance and assist employees with scheduling accrued vacation. Schedule it for them if they have not done so after three months. Cease accrual in the last three months before the change so that you can manage the accrued balances.
2. Put unused vacation in a bank that can be used for extended illnesses/disabilities but will otherwise be paid at termination.
3. Require employees transitioning to the unlimited PTO policy to sign documentation that outlines the number of days accrued and unused and the terms of PTO payout.
4. Cash out the accrued PTO on a set date prior to the implementation of the unlimited PTO policy, if the company wants to avoid paying PTO at termination.

As always, employers should consult legal counsel to assist in policies covering PTO, vacation and leaves mandated by law.